DEED OF TRUST ON STORE FIXTURES AND STOCK OF GOODS.

Opinion prevails among the bar and bench, that a deed of trust on the above kind of property is invalid, or fraudulent *per se*, whenever the grantor reserves the possession and power to sell, expressly or impliedly, and the trustee is to sell only in default of payment when the debt secured, or any part thereof, becomes payable, and upon request of the creditor.

This ought not to be the law, and we cannot bring ourselves to the conclusion that our Court of Appeals has so decided, or will so decide, although the cases seem to point that way. We shall not undertake to review in detail the Virginia cases on this vexed and much litigated subject. The cases are as follows: *Lang* v. *Lee*, 3 Rand. 410; *Sheppards* v. *Turpin*, 3 Gratt. 373; *Spence* v. *Bagwell*, 6 Gratt. 444; *Addington* v. *Etheridge*, 12 Gratt. 436; *Marks* v. *Hill*, 15 Gratt. 400; *Perry* v. *Shenandoah National Bank*, 27 Gratt. 755; *McCormick* v. *Atkinson*, 78 Va. 9; *Wray* v. *Davenport*, 79 Va. 19; *Saunders* v. *Waggoner*, 82 Va. 316; *Hughes* v. *Epling*, 93 Va. 424. See also *Brockenbrough* v. *Brockenbrough*, 31 Gratt. 580; *Young* v. *Willis*, 82 Va. 291; *Paul* v. *Baugh*, 85 Va. 955; *Norris* v. *Lake*, 89 Va. 513; and cases cited. These last cited are cases involving personal property other than fixtures and stock of goods.

We think we can safely say, that in all the cases in which the court declared the deeds invalid, it did so, not upon the single and isolated fact of possession and power to sell by the grantor, until default and until the trustee is requested by the creditor to sell, etc., but upon that fact, coupled with other evidence apparent on the face of the deed, and extrinsic thereto, such as, in many of them, the unreasonably long time allowed for the payment of the debt, or any part thereof, and the uncertainty that the deed was ever to be executed. The Court of Appeals has not yet said, in terms or by necessary implication, that the possession and power to sell by the grantor until default, etc., are alone sufficient to vitiate the deed; it had the opportunity to lay down that precise rule in numerous cases, notably in the case of *Hughes* v. *Epling*, 93 Va. 424. In that case the deed provided, that the grantor be "suffered to remain in possession and *enjoyment* of the stock of goods or merchandize until default" should

be made in the payment of the negotiable notes, *or any renewals or continuations of the same*, or any part thereof, or in the payment of the debt secured, and until G. W. Epling, the endorser and creditor, should require the trustee to sell. (Italics ours.) This was a plain case of the grantor being left in possession, not only with the power to sell but of *enjoyment* of the property, and the court could easily have said that this alone was sufficient to vitiate the deed if it had so intended; but the court said, "the terms of the trust . . . . . necessarily imply that he had the right to dispose of the goods in his business for his *own benefit*" [evidently referring to the term "enjoyment"], "and to continue to do so as long as the negotiable notes could be renewed and the party secured was content not to require a sale." (Italics ours.) The court clearly decided the case on the grounds that the grantor retained the right of *enjoyment* for probably an indefinite period. The provision as to the notes, the renewal and continuation of the same, was a limitation and contingency fatal to the deed, in that it gave possession to the grantor for an unreasonable and uncertain time, well calculated and adequate to defeat the purpose of the deed, the ready and prompt payment of the debt, or the enforcement of the deed if the debt was not paid in a reasonable time.

But suppose the deed had provided that, "The grantor shall be suffered to remain in possession and to sell the goods and merchandize in the usual course of trade," and the notes had been made payable monthly from date of deed, and upon default in any one of them the trustee was required to sell upon request of the creditor. This gets rid of the too liberal term "enjoyment," and the provision as to the notes would render it quite probable, if not certain, that the grantor would conduct his business with a view to pay off the debt. It is at least an assurance of the grantor's intention to promote the purpose of the deed, and makes it reasonably certain that it will be paid, for the grantor would hardly risk the closing of his business by sale by the trustee, if any one of the notes was not paid at maturity.

We think, therefore, that a deed of trust on a stock of goods and store fixtures should be held valid, even though the grantor reserves possession and power to sell, etc., if, on the face of the deed, it appears to be a *bona fide* transaction (there, of course, being no extrinsic evidence *contra*), and there are specific provisions in the deed fixing the amount of the debt, and a reasonable time in which it is to be paid in part or in full, with directions to the trustee to sell upon the request of the creditor if default is made in payment of the debt or

any part thereof. A contrary rule is a restraint upon the alienation of property, and hampers commercial transactions.

As to the claim of unsecured creditors that they will be injured, I cite the case of *Etheridge* v. *Sperry*, 139 U. S. p. 266, in which the court sustained a mortgage on a stock of goods, affirming the decision of the Supreme Court of Iowa. Of course the Supreme Court of the United States affirmed the decision of the State Court chiefly on the ground that the decision was on a question of local concern, but Justice Brewer, delivering the opinion, said :

"The only parties who can claim to be injuriously affected are unsecured creditors. But they are notified by the record of the exact relations between the mortgagor and mortgagee; and surely subsequent creditors cannot complain if they deal with the mortgagor with full knowledge of such relations. Existing creditors may of course challenge the good faith of the transaction, but if they cannot disturb an absolute sale when made in good faith, why should they be permitted to challenge a conditional sale if made in like good faith? The fact that fraudulent relations are possible is hardly a sufficient reason for denouncing transactions which are not fraudulent."

The court also said generally :

"We are aware that there is great diversity in the rulings on this question by the courts of the several States. . . . Indeed if this were an open question we could not be blind to the fact that the tendency of this commercial age is towards increased facilities in the transfer of property, and to uphold such transfers so far as they are made in good faith ; and it is at least worthy of thought, whether the rulings made by the Supreme Court of Iowa do not tend to make chattel mortgages more valuable for commercial purposes, without endangering the rights of unsecured creditors."

In conclusion the court said:

"So, if the question were open, or a new one unaffected by any settled law of the State, we incline to the opinion, that the question is not one of law, so much as it is one of fact and good faith, and that the decision of the Supreme Court of Iowa rests on sound principles."

A deed of trust of the character here discussed cannot be held invalid solely because the possession and power to sell the goods is left with the grantor, except upon the presumption of *mala fides*, or fraud. Much has been said in this class of cases to the effect that debtors frequently resort to this method of encumbering their property, as a mere device to shield it from their (unsecured) creditors. This view of the question is nothing less than a presumption of fraudulent intent, discarded by all respectable courts, and none more so than by our Court of Appeals, and may it ever be so. Debtors are men as well as creditors and equally honest. The former are, as a rule, as anxious to pay

what they owe, as the latter are to collect what is due them, unless we confess that the avarice of the creditor is a stronger passion than the debtor's sense of honor or pecuniary obligation. Instead, then, of presuming that a debtor who has given his deed of trust (remaining in possession and control of the property, because essential to the continuation of his business and occupation), with the purpose and device to cheat his creditors, rather let it be presumed that he gave it with the honest intention to pay the debt secured. Such a rule of presumption of bad faith and fraudulent intent cannot be justified in morals or law, and if applied in cases of this character will in most instances result disastrously both to creditor and debtor. Justice Brewer said in *Etheridge* v. *Sperry, supra:*

"The interests of the general public are not prejudiced by any such transaction between debtor and creditor. Indeed, they are rather promoted by any arrangement under which the mortgagor can continue in business, for in ninety-nine cases out of a hundred the taking of possession by a creditor results in closing the business and turning the debtor out of employment."

"The question is not one of law, so much as it is one of fact and good faith." *Etheridge* v. *Sperry*, 139 U. S. 278.

The late lamented Judge Burks, in *Brockenbrough* v. *Brockenbrough*, 31 Gratt. 590, after referring to *Lang* v. *Lee, supra*, and that class of cases, said:

"While, however, the principle referred to is established by these decisions, it is equally well settled, in this State at least, that no irresistible inference of intent to defraud is deducible from a provision in a deed of trust postponing a sale of the property conveyed for a reasonable length of time, and reserving the use of the property to the grantor until sale, even although a portion of the property conveyed may be perishable in its nature and consumable in the use; nor is such inference a necessary deduction from the omission to annex a schedule or inventory of the property to the deed; nor is the inference a necessary one where all these circumstances exist in the same case." (See cases cited.) "I do not mean to say that these circumstances apparent by the deed, when taken in connection with extrinsic evidence, are not entitled to weight in determining the question of intent. I think they are so entitled; but alone they are not sufficient to establish fraud. They are consistent with an honest purpose. The presumption of law is in favor of honesty and 'the court cannot presume fraud unless the terms of the instrument preclude any other inference.'" (*Dance* v. *Seaman*, 11 Gratt. 778.)

See also *Young* v. *Willis*, 82 Va. 291; *Paul* v. *Baugh*, 85 Va. 955; *Norris* v. *Lake*, 89 Va. 513.

In *Peabody* v. *Landon*, 15 Am. St. R. 903 (61 Vt. 318), it was held:

"A mortgage duly recorded, declaring that the mortgagor may remain in possession, and sell the mortgaged property as opportunity presents, the property

as sold to be replaced with other of like kind and of sufficient value to keep the security of the mortgage good, but not providing that the avails of the sales shall be accounted for by the mortgagor, is *prima facie* valid as against an attaching creditor of the mortgagor." (Syllabus.)

In the note to this case it is said :

"Perhaps no topic of the law has been more thoroughly discussed or more frequently decided than the one under consideration. Certain it is that none can be found in which judicial opinion so widely differs, and as has been said the cases cannot be reconciled by any process of reasoning or any principle of law."

A number of authorities are cited for and against the decision in the principal case; in mere *number* they are adverse to the decision, and as we think the question is not *res judicata* in Virginia, we submit that the better rule is to hold such mortgages valid. It will be specially noted in the above note that the first case cited as against the validity of such mortgages is *Robinson* v. *Elliott*, 22 Wall. 513, and the editor says :

"Perhaps the leading case in support of this doctrine, because of the source from which it emanated, is that of *Robinson* v. *Elliott*, *supra*, where the Supreme Court of the United States gave unqualified approval to the principle that a mortgage of a stock of goods containing a provision authorizing the mortgagor to retain possession for the purpose of selling in the usual course of business, and to use the money thus obtained to replenish his stock, is invalid, as matter of law, and the court may pronounce it void."

This case of *Robinson* v. *Elliott* is very much discussed by the judges holding different views of this question; those favoring the *invalidity* of such mortgages laying great store by the decision, because it comes from the highest and the greatest court in the world. *Robinson* v. *Elliott*, *supra*, was decided in 1874. In 1890 the Supreme Court of the United States decided the case of *Etheridge* v. *Sperry*, *supra*, in which the court said, referring to the decision of *Robinson* v. *Elliott:*

"It was not intended by that decision to hold that a chattel mortgage was void because it provided for a retention of possession by the mortgagor and a sale by him."

And as we have already quoted, but which we repeat, the court also said:

"The fact that fraudulent relations are possible is hardly a sufficient reason for denouncing transactions which are not fraudulent. So if the question were open or a new one unaffected by any settled law of the State, we incline to the opinion that the question is not one of law so much as it is one of fact and good faith."

So we see that the Supreme Court has not only said that *Robinson* v. *Elliott*, decided in 1874, is misunderstood and misinterpreted, but

looking from a higher point of an advanced commercial period in 1890, holds a mortgage of this kind valid, commends the wisdom of the decision of the State court so holding, and says, most emphatically, "that the question is not one of law, so much as it is one of fact and good faith."

It is true that in the note to *Peabody* v. *Landon* (*supra*) the Virginia cases of *Lang* v. *Lee* and *Addington* v. *Etheridge* are cited in support of the view that mortgages of this kind are fraudulent *per se*. As to the former case (decided in 1825), there were features engrafted on the deed, and evidence on its face, as well as extrinsic thereto, other than the mere reservation of possession and power of sale in the grantor, which were clearly prejudicial to creditors. The latter case (*Addington v. Etheridge*) is, we admit, a strong case in favor of the view opposed to that advanced in this article, but that case was decided so early as 1855, and it cannot control in view of the principles and rules so strongly enunciated in the subsequent and quite recent decisions in 31 Grat. 580; 82 Va. 291; 85 Va. 955; 89 Va. 513, cited above, although we are aware that these last cases involve deeds on personal property other than stocks of goods; and the cases subsequent to those last above cited holding deeds on stock of goods invalid are cases in which there were facts apparent on the face of the deed and extrinsic thereto, other than the mere fact of possession and power of sale reserved by the grantor, to which the court looked and had under consideration in its decisions.

We submit, therefore, that, if there is nothing in the terms or provisions of the deed to *defeat* its purpose (and such a deed can be easily drawn), and there is no evidence of *mala fides* in the transaction, mere possession and control of the goods, with power in the trustee to sell upon default of payment of the debt secured, or any part thereof, upon request of the secured creditor, should not render the deed invalid. Surely there would be slight or no danger of a defeat of the purpose of the deed if the debt secured is divided and made payable in instalments to fall due at short intervals from the date of the deed; if this is done, the secured creditor, with proper vigilance and attention to his rights and interests, would run little risk of losing the benefit of the security which he consented to take. Existing and subsequent unsecured creditors could not be heard to complain; the former, not any more than if there was absolute sale of the goods in good faith; nor the latter, for they are notified by the record of the deed of trust. The insignificant risk of the security being defeated (and that is the

only possible ground of objection to these deeds, if they are drawn with care, and there is no *mala fides*), is not sufficient reason for declaring such deeds invalid, thereby restricting the free transfer of property and placing a serious obstruction in the path of commercial convenience.

I have discussed this question without reference to whether or not the creditors secured in the deed had accepted it or consented to the security; they being often more than satisfied to rely, not only upon the property, but upon the good faith of the grantor and the continuation and profitableness of his business, rather than "close him up" because of any temporary inability on his part to pay.

But if the secured creditors did accept the deed, and, as was said by the Supreme Court of the United States, *supra*, the unsecured creditors have no right to complain, except they challenge the good faith of the transaction, and there are provisions in the deed, such as I have enumerated above, "not incompatible with nor adequate to defeat the purpose of the deed," but looking to a ready and prompt payment of the debt by instalments or as a whole, how can the mere possession and power to sell remaining in the grantor invalidate the deed, the trustee being empowered to sell upon default in payment of the debt, or any part thereof, on request of the creditor?

Of course, under the decision, a deed of trust of this character and on this class of goods would be valid with a provision requiring a strict accountability from the grantor to the trustee, on placing the property under the control of the trustee, but such provisions would in most instances be impracticable, unwise, and, from the views here presented, unnecessary; such provisions require too much of the grantor and impose too great responsibility and service upon the trustee for the compensation usually received in such cases. As the decisions now stand, however, it would be safer to insert these provisions wherever it can be done.

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